



YourQ&A: How Do Funds Use Leverage?

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Question

Can leverage be used as part of an alternative strategy within the '40 Act space?

Executive, Top 10 Fund Firm, Northeast

Answer



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Advisors have referred to our SmartGrowth fund family as alternative strategies. These '40 Act funds, which are essentially funds of exchange-traded funds (ETFs), track the Lipper Optimal Target Risk Indices. As a portfolio manager of the family, I have taken leveraged short exchange-traded fund positions to implement those indices.

The indices are objective, risk-based tools composed of carefully selected ETFs that are rebalanced on a quarterly basis. Their overriding objective is providing an appropriate combination of ETFs for different levels of risk appetites. The indices, and by extension the funds themselves, have taken on several defensive positions since the summer of 2007. These defensive positions have not only included bond-oriented ETFs but also short and leveraged short ETF positions on certain asset classes, sectors, styles and market caps.

ProFunds' ProShares also offers leveraged positions via ETFs. These types of leveraged and non-leveraged short and long ETF products have presented investors and advisors with the ability to add diversification and, at times, downside protection to their investment portfolios. These products have also afforded mutual fund portfolio managers the opportunity to utilize leverage selectively within their own fund offerings.

One has to be careful to control the amount of leveraged exposure that one has not only to a given asset class, sector, style or market cap but also within one's portfolio as a whole. Keep in mind that when the market moves against a particular holding, the associated losses are magnified.

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